

Report on the Audit of Potential Supervision and Regulation Conflicts of Interest (A9105)

This audit assessed the effectiveness and efficiency of the Board's ethics rules and internal controls to prevent and detect actual or apparent conflicts of interest among Board and Reserve Bank staff engaged in the supervision and regulation (S&R) of certain financial institutions such as state member banks and bank holding companies. The Board has a long-standing policy that Federal Reserve System employees maintain unusually high standards of honesty, integrity, impartiality, and conduct to ensure the proper performance of Federal Reserve business and the maintenance of confidence in the System by persons both within and outside the government. To achieve these high standards, Board employees must comply with federal civil ethics laws, as well as ethics and conduct regulations provided by the Board and Office of Government Ethics (OGE), while Reserve Bank employees are expected to follow separate ethics rules developed by the individual Reserve Banks in line with Board policies. In addition, all Board and Reserve Bank employees must comply with conflict of interest criminal statutes applicable to federal personnel, and Federal Reserve bank examiners are subject to additional specific criminal prohibitions against borrowing relationships with examined banks.

Overall, we found that the ethics programs at the Board and most Reserve Banks were not sufficiently effective to ensure S&R staff compliance with the Board's conflict of interest rules and policies. We found significant differences in financial disclosure and work assignment restrictions for System S&R personnel during our on-site review of a statistical sample of financial disclosure reports filed by Board and Reserve Bank S&R personnel that were relevant to their 1990 work activities. In our judgment, weaknesses and differences occurred because the management structure and the rules and procedures for the Board's ethics program had not kept pace with requirements in federal law, OGE regulations, and Board mission responsibilities, and the Reserve Banks' ethics programs were given the latitude to implement their own ethics rules and conflict of interest processes without effective Board guidance and oversight.

Because we found that many of the ethics activities applied to S&R personnel were but a specific application of general ethics activities applicable to all covered employees at each Reserve Bank and at the Board, we made ten recommendations to the Board directed at establishing an effective, efficient, and sustainable ethics program for the entire System. Our first and most important recommendation was that the Board establish a System management structure for providing leadership, coordination, and accountability for an effective and efficient Systemwide ethics program consistent with OGE regulations and federal law. Three supporting recommendations addressed the needed elements of such a Systemwide ethics program, including adequate resources at the Board, a quality assurance component to ensure Systemwide conformity, and provisions for System ethics education. The fifth recommendation addressed the need for the System to establish comprehensive and up-to-date ethics rules and policy guidance. Our five remaining recommendations were aimed at achieving administrative consistency, efficiency, and effectiveness. More specifically, we recommended that the System's ethics program ensure uniformity in identifying who should file confidential financial disclosure reports, adopting confidential disclosure forms, reviewing disclosure reports, obtaining ethics agreements to effect any remedial actions, and restricting work activities.

Board management, in consultation with Reserve Bank officials, stated full or partial agreement with our recommendations and described several steps taken or planned to be taken to implement them. Although we concurred with many of the specific actions described, we emphasized that the Board should: (1) take the lead in developing a more coordinated and consistently performed ethics program, (2) require that Reserve Bank ethics officials communicate significant ethics policy interpretations, (3) direct the Board's ethics officer to perform quality assurance reviews of Reserve Bank ethics programs, (4) evaluate ethics staffing levels at the Board, and (5) ensure that ethics regulations applied to Board staff are consistent with Board policies promulgated for Reserve Bank staff.